TRD Legislative Proposals – Alternatives Under Consideration

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Revenue Stabilization and Tax Policy Committee

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August 29, 2007

Summary of Presentation

- **Personal Income Tax Simplification**
- **Tax Increment Financing (TIF)**
- **Business Tax Credits**

Personal Income Tax Simplification

Policy Goals

- **Reduce the time taxpayers devote to record keeping, tax return preparation, and return filing**

- **Reduce out-of-pocket payments to return preparers**

- **Increase fairness across families**

Personal Income Tax Simplification – Continued

<u>Current Law</u>

- **New Mexico taxable income is computed as follows:**

  Start with federal AGI

  + NM additions (e.g., interest on federally tax-exempt bonds)

  - Federal standard or itemized deductions

  - Federal personal exemption amount

  - NM low- and middle-income exemption

  - NM subtractions (e.g., interest on NM S&L bonds, capital gains)

  - NM medical care deduction

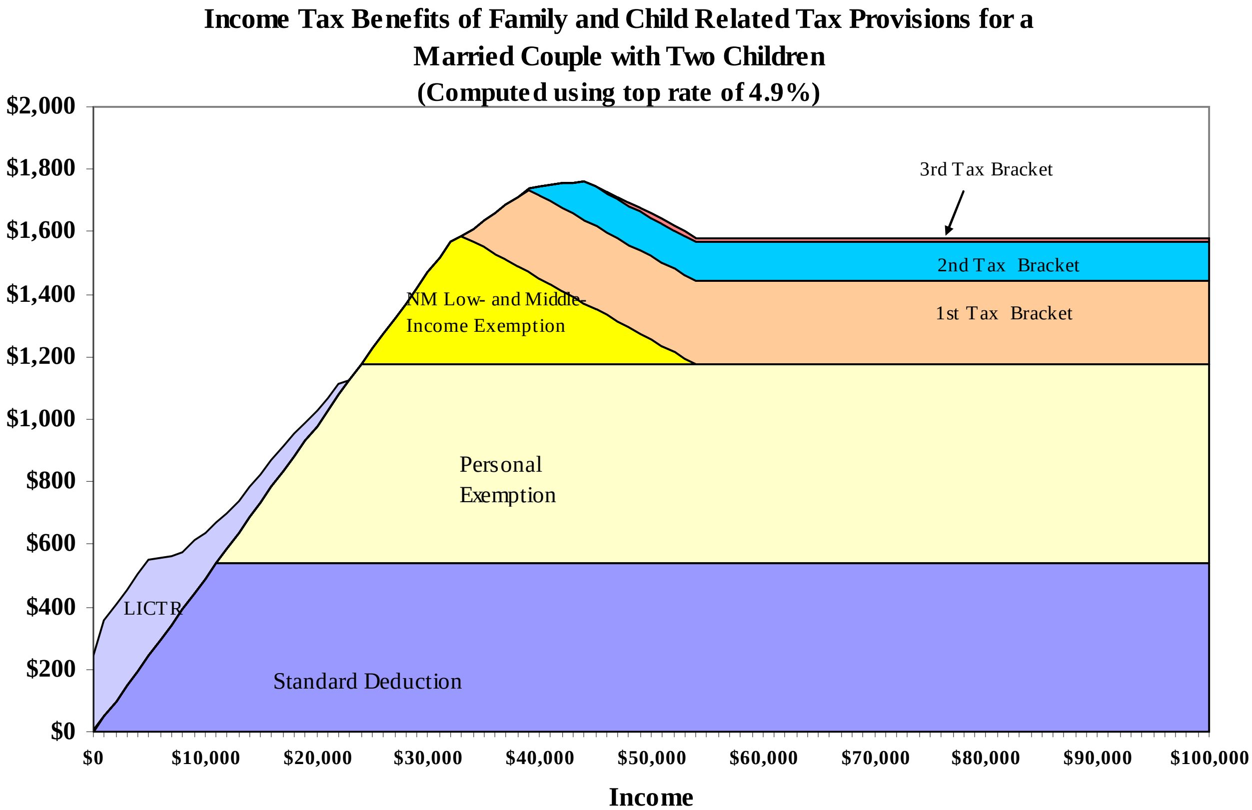
  = NM taxable income

- **Tax liability is computed at graduated rates**
  - **Rates rise from 1.7% to 5.3% in 2007**
  - **The top rate is reduced to 4.9% starting in 2008**
- **Tax rebates and credits are computed and applied**
  - **Most credits are nonrefundable**
  - **Refundable rebates and credits (except the new Working Families Tax Credit) are conditioned on "Modified Gross Income" (MGI)**
- **Withholding and estimated payments are applied**
- **Taxpayers compute their tax due or refund**

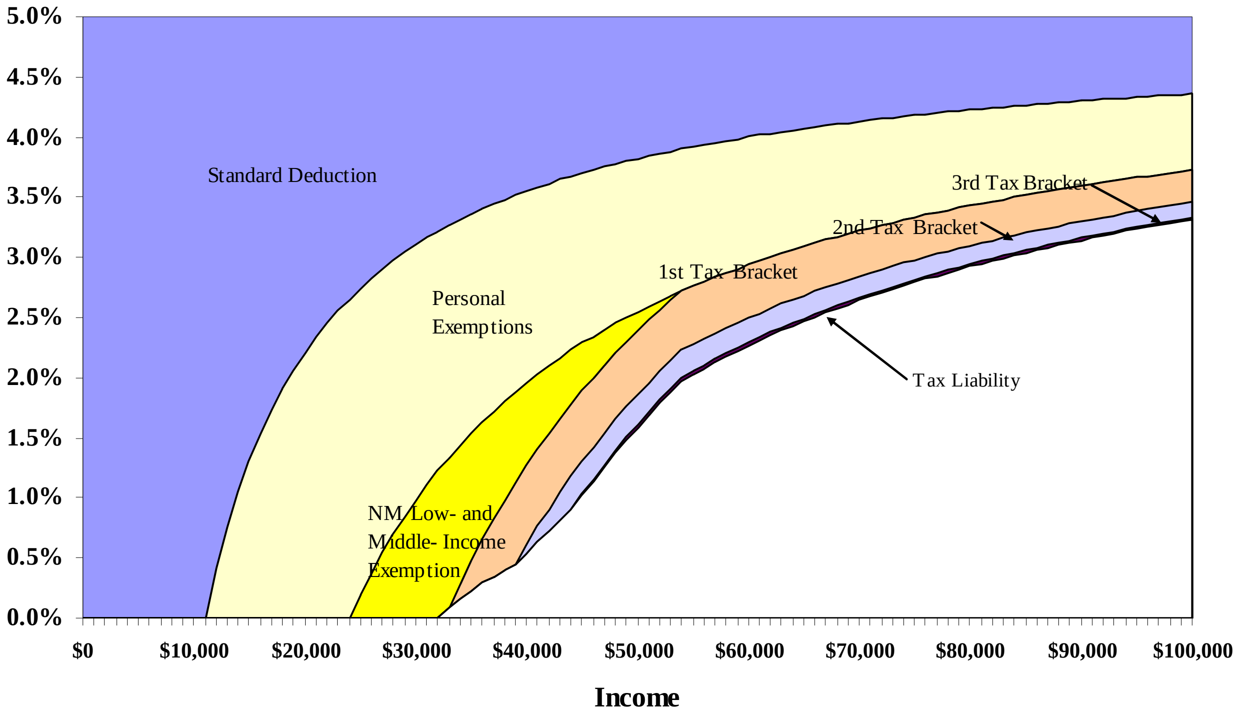
Personal Income Tax Simplification – Continued

Family and Child Related Tax Benefits

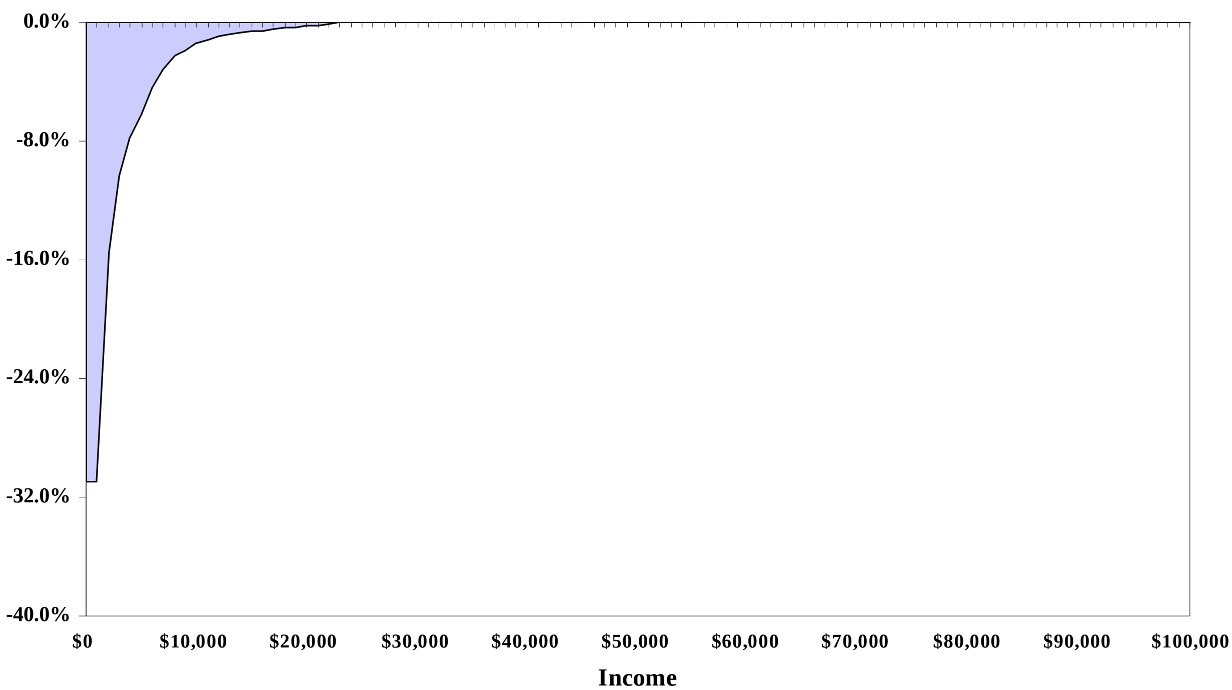
- **Progressivity is achieved primarily through certain family and child related tax benefits:**
  - **Standard deduction**
  - **Personal exemptions**
  - **NM low- and middle-income exemption**
  - **Graduated rates**
  - **LICTR**
- **The following six graphs illustrate how these family and child related tax benefits contribute to progressivity**
  - **The first graph shows the dollar value of each of these benefits for a family of four at income levels up to $100,000**
    - **The computations are made using the top 2008 rate of 4.9%**
  - **The second and third graphs show these dollar amounts expressed as a percentage of income**
  - **The following three graphs show the dollar value and percentage of income figures for a single individual**
- **Beginning in 2008, the Working Families Tax Credit will also add to progressivity**
  - **This credit is 8% of the federal EITC amount**
  - **Only families with earned income qualify**
  - **For these reasons, it cannot easily be integrated with the other benefits and therefore is omitted from the graphs and proposal**


Income Tax Benefits of Family and Child Related Tax Provisions for a Married Couple with Two Children
(Computed using top rate of 4.9%)
$2,000
$1,800
$1,600
$1,400
$1,200
$1,000
$800
$600
$400
$200
$0
3rd Tax Bracket
2nd Tax Bracket
1st Tax Bracket
NM Low- and Middle-Income Exemption
Personal Exemption
LICTR
Standard Deduction
$0
$10,000
$20,000
$30,000
$40,000
$50,000
$60,000
$70,000
$80,000
$90,000
$100,000
Income

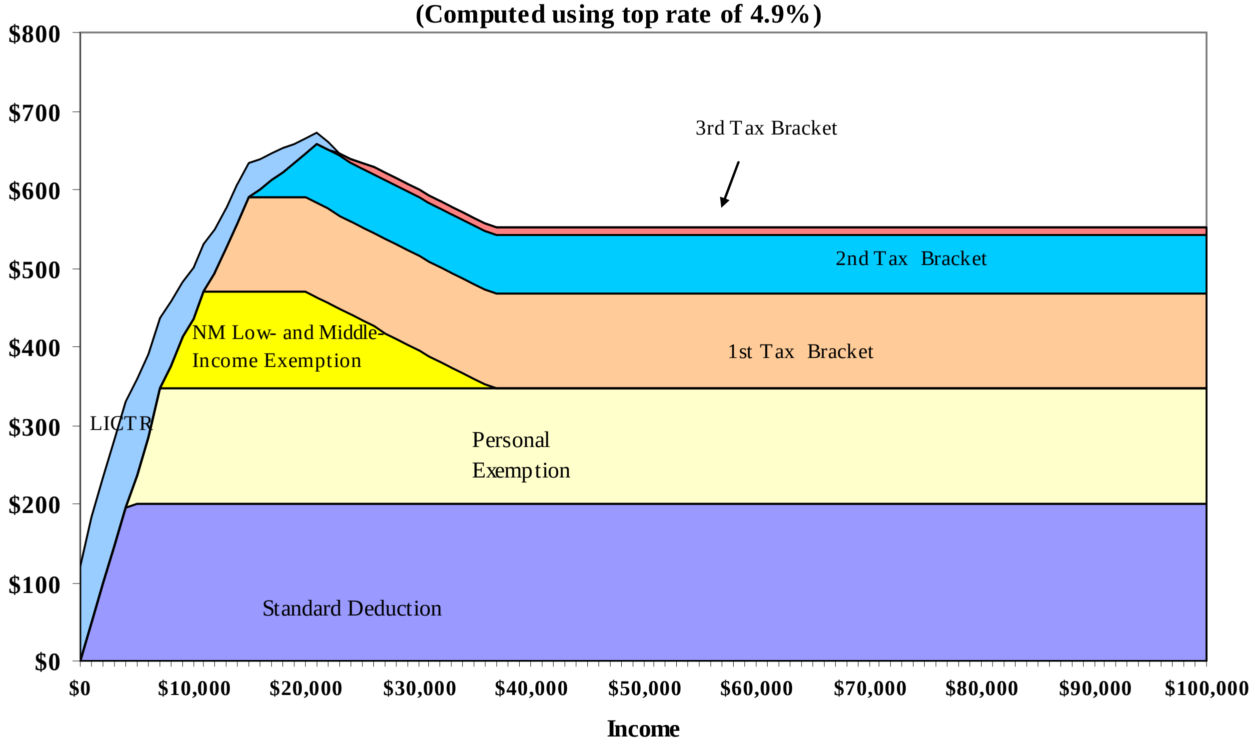
Income Taxes as a Percentage of Income for a Married Couple with Two Children (Computed using top rate of 4.9%)



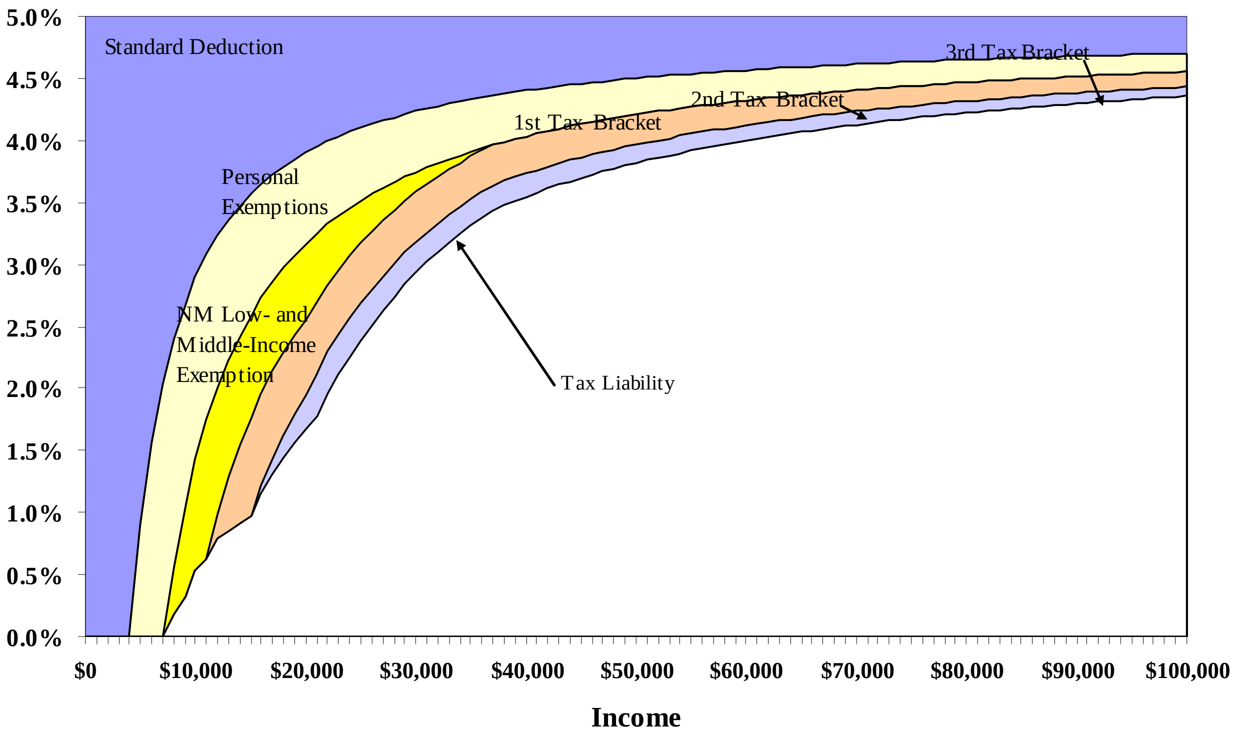
Low Income Comprehensive Tax Rebate (LICTR) as a Percentage of Income for a Married Couple with Two Children



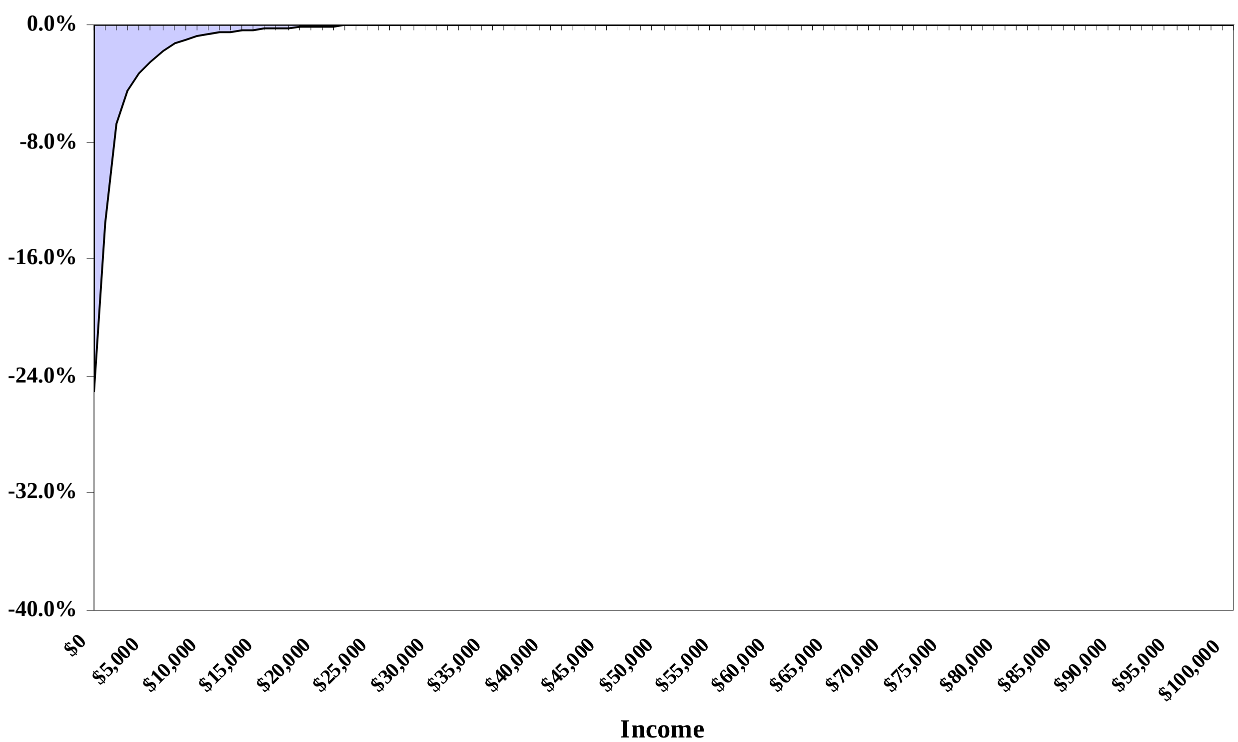
Income Tax Benefits of Family and Child Related Tax Provisions for a Single Taxpayer
(Computed using top rate of 4.9%)



Income Taxes as a Percentage of Income for a Single Taxpayer
(Computed using top rate of 4.9%)



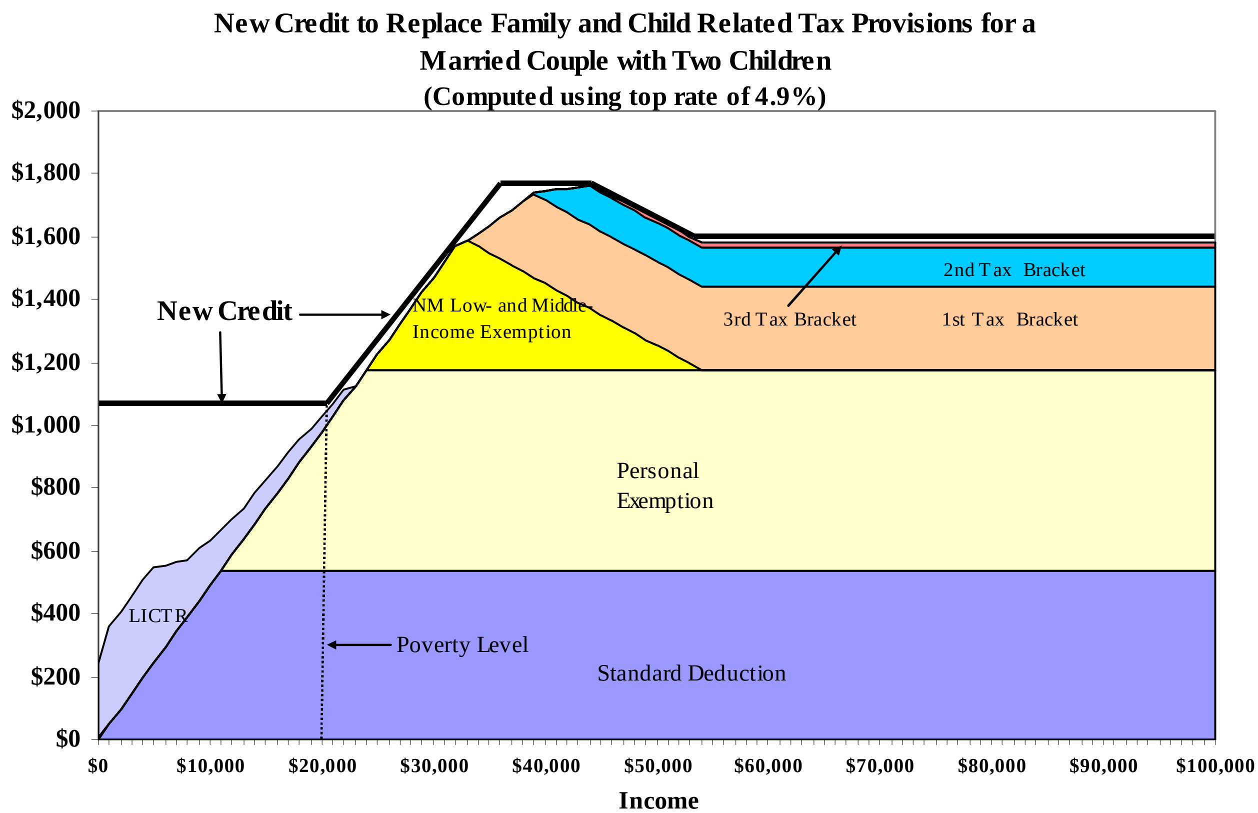
Low Income Comprehensive Tax Rebate (LICTR) as a Percentage of Income for a Single Taxpayer



Personal Income Tax Simplification – Continued

<u>Alternatives Under Consideration</u>

- **Combine the family and child related tax benefits into a new credit**
  - **The new credit would replace the standard deduction, personal exemptions, NM low- and middle-income exemption, graduated rates, and LICTR**
  - **The new credit would vary with filing status, family size (number of dependents), and income**
  - **Income for purposes of the new credit would be "Modified Gross Income" (MGI)**
- **Greatly simplify the definition of MGI**
  - **For most taxpayers, MGI is the same as federal AGI**
  - **Low-income families are most likely to have differences between MGI and AGI because MGI includes total Social Security benefits and TANF, SSI and other benefits not included in AGI**
    - **Benefits other than Social Security tend to be relatively small and difficult for many families to track carefully and to verify**
  - **The simplified definition would add to federal AGI only the non-taxable portion of Social Security benefits**
    - **Adding non-taxable Social Security benefits would generally increase the amount of the new credit for lower-income recipients**
- **The new credit could closely replicate current family and child related tax benefits (see following graph for a family of four)**
  - **For income levels below the poverty level, the credit would be a constant amount (for each family type and size), to offset the simplification of MGI**


New Credit to Replace Family and Child Related Tax Provisions for a Married Couple with Two Children
(Computed using top rate of 4.9%)
$2,000
$1,800
$1,600
$1,400
$1,200
$1,000
$800
$600
$400
$200
$0
New Credit
NM Low- and Middle-Income Exemption
3rd Tax Bracket
2nd Tax Bracket
1st Tax Bracket
Personal Exemption
LICTR
Poverty Level
Standard Deduction
$0
$10,000
$20,000
$30,000
$40,000
$50,000
$60,000
$70,000
$80,000
$90,000
$100,000
Income

Personal Income Tax Simplification – Continued

Effect of Alternative

- **The new credit would simplify the personal income tax by:**
  - **Removing the need to include the standard deduction, personal exemptions, and the NM low- and middle-income exemption in the computation of income subject to tax**
    - **For most taxpayers, NM taxable income would be federal AGI**
    - **Itemizers would deduct the excess of their federal itemized deductions over the standard deduction (already in new credit)**
  - **Simplify the computation of tax liability, since there would only be one rate (4.9% beginning in 2008)**
    - **The value of lower rates would be included in the new credit**
  - **Simplify the computation of MGI**
  - **Most families would be able to compute their tax by simply:**
    - **Looking up their tax amount in a table based on AGI, filing status and family size, and**
    - **Looking up their new credit amount in a table based on MGI (which typically would be the same as AGI), filing status and family size**
- **The new credit would also smooth out the pattern of family and child related tax benefits, increasing fairness across families**

Tax Increment Financing (TIF)

Background

- **The Mesa del Sol development will begin receiving gross receipts tax increment distributions for gross receipts tax liabilities reported on or after January 1, 2008**

- **Other TIF districts are under consideration**

- **During the process of preparing to implement distributions to Mesa del Sol, TRD identified a number of issues related to TIFs that may require legislative clarifications and appropriations to implement**

Alternatives Under Consideration

- **The phrases "base gross receipts taxes" and "gross receipts tax increment" are defined in terms of tax collection, but should be defined as taxable gross receipts before the food and medical deduction**

  - **Without this change, there would be no TIF distribution for food or medical sales**

- **"Base gross receipts taxes" must be determined by an estimate which will be difficult to develop**

  - **Instead, they could be estimated from actual receipts in the first year a district has a dedicated gross receipts tax increment**

- **The 25-year limit from the date the first bond is issued on the term of all bonds issued by a district creates a strong incentive for projects to be divided into multiple districts**

  - **Each district requires a separate location code for reporting gross receipts taxes, imposing reporting and administrative burdens and increasing the likelihood of errors**

  - **As an alternative, districts could be allowed to bond for 25 years against the increment to its gross receipts tax base in each of the**

initial years of the district, so the project's 25-year term bonding authority is staggered over the development phase of the project

- **Under current law, there is no provision for the allocation of any excess amounts of TIF distributions after the termination of the district (and repayment of any outstanding bonds), and it has been suggested that a governing body could withdraw any revenue not needed for debt service at any time**
  - **Explicit rules should describe the circumstances under which there are "excess increment revenues" that can be used for purposes other than debt service on increment bonds**
  - **These rules should also specify which portion of those revenues revert to the General Fund if any part of the gross receipts tax increment distributions were dedicated by the State Board of Finance from state gross receipts taxes**
- **Some additional minor technical changes may also be needed to clarify the law and facilitate tax compliance and administration**
- **TRD will need to make significant system changes to make distributions to a district that has a non-zero gross receipts base, or a change in area**
  - **We will not be able to accomplish these system changes without additional funding, provided with sufficient lead time**

Business Tax Credits

Policy Goals

- **Improve the specification of business tax credits to make them simpler, more uniform, and more effective**
    - **Simplification would reduce compliance costs for businesses and make the credits easier for TRD to administer and for operating agencies to certify, monitor and evaluate the credits**
    - **Uniformity would help assure that business tax credits operate as intended to meet their objectives and would provide additional simplification**
    - **Some of the credits could be made more effective with better targeting of the tax incentive**

Current Law

- **The following three tables summarize many of the key features of current business tax credits**
    - **The tables are arranged by type of credit: Investment-Related (Table 1), Employment-Related (Table 2), and Other (Table 3)**
- **The tables demonstrate the lack of uniformity in the current credits with regard to many of the key features, even within the same type of credit**

Table 1
Investment-Related Business Tax Credits

Type of Credit	Investment Credit	Affordable Housing	Cultural Property	Facility Rehabilitation	Electronic ID Card Reader	Solar Energy Systems	Sustainable Buildings	Angel Investment	Advanced Energy	Alternative Energy Products
Statute	7-9A	7-9I	7-2-18.2; 7-2A-8.6	7-2-18.4; 7-2A-15	7-2-18.8; 7-2A-18	7-2-18.14	Laws 2007, Ch. 204	Laws 2007, Ch. 172	Laws 2007, Ch. 204	Laws 2007, Ch. 204
Taxes Applied Against	CRS (State GRT)	All CRS except local GRT options & GGRT; PIT; CIT	PIT/CIT	PIT; CIT	PIT; CIT	PIT	PIT; CIT	PIT	CRS	CRS (State GRT)
Credit rate	5% of equipment incorporated in a manufacturing operation	50% of property contributions	50% of cost of preserving cultural property up to $50,000	50% of cost of rehabilitating business property up to $50,000	$300 per location at which equipment is used	30% of cost of solar system purchase and installation less federal credit allowed	Variable amount per square foot depending on energy efficiency rating	25% of investment up to $100,000 per taxpayer	6% of costs of qualified facilities, up to $60 million per facility	5% of manufacturing equipment
Eligibility	One added employee for every $500,000 of equipment up to $30,000,000 or per $1 million of equipment over $30,000,000	Contribution of land, buildings, cash or services for project approved by MFA	Owner of cultural property	Business property must be located in an Enterprise Zone and must have been vacant for 24 months	Owner of equipment for reading ID's	Not allowed for pool heating or for commercial systems	Building must be certified by EMNRD	Eligibility must be certified by Economic Development Department	Taxpayer must be certified by the Environment Department	One added employee for every $500,000 of equipment up to $30,000,000 or per $1 million of equipment over $30,000,000
PTE Allocation Rules	No	No	Yes	Yes	Yes	No	Yes	Yes	No	No
Carry Forward	Indefinite	5 Years	4 Years	4 Years	No	10 Years	7 years	3 Years	5 Years	5 Years
Refundable	Partial	No	No	No	No	No	No	No	No	No
Transferable	No	Yes	No	No	No	No	Yes	No	No	No
Recapture	No	No	No	No	No	No	No	No	Partial	Yes
Sunset	No	No	No	No	No	31-Dec-15	31-Dec-03	31-Dec-11	31-Dec-15	No
Anti-Double Dip	No	Partial	No	Partial	No	No	Partial	No	Yes	No
Overall Cap (annual)	No	$3.7 million	No	No	No	$5 Million	$10 million	$750,000	No	No
Review Required	Yes	No	No	No	No	No	No	EDD	NMED	No

Table 2
Employment-Related Business Tax Credits

Type of Credit	Technology Jobs Tax Credit	High Wage Jobs Tax Credit	Rural Job Tax Credit	Welfare-to-Work	Job Mentorship
Statute	7-9F	7-9G	7-2E	7-2-18.5	7-2-18.11; 7-2A-17.1
Taxes Applied Against	CRS (State GRT); PIT; CIT	All CRS except local option GRT.	All CRS except local option GRT	CIT	PIT; CIT
Credit rate	8% (16% in rural areas) of expenditures	10% of wages up to $12,000 per employee for each of four years	25% of first $16,000 wages (rural) or 12.5% of first $16,000 (urban)	50% of federal Welfare-to-Work credit	50% of wages of up to 10 students up to $12,000
Eligibility	$75,000 payroll increase per $1 million expenditures	Employment one year after hire must exceed the level one day prior to the hire	Employer must be approved for Job Training Partnership Program	Total employment must increase; must be in high-unemployment county	Student eligibility is certified by secondary schools
PTE Allocation Rules	No	No	No	Yes	Yes
Carry Forward	Indefinite	No	Yes	3 Years	3 Years
Refund-able	No	Yes	No	No	No
Transfer-able	No	No	Yes	No	No
Recapture	Yes	No	No	No	No
Sunset	No	6/30/2009	6/30/2006	No	No
Anti-Double Dip	Partial	No	Partial	No	No
Overall Cap	No	No	No	No	No
Review Required	TRD	No	EDD & NMDOL	No	No

Table 3
Other Business Tax Credits

Type of Credit	Laboratory Partnership with Small Business	Small Business R&D Holiday	Land Conservation	Renewable Energy Production	Film Production	Biodiesel Fuel Production	Biodiesel Facility
Statute	7-9E	7-9H	7-2-18.10; 7-2A 8.9	Laws 2007; 7-2A 19	7-2F	Laws 2007, Ch. 204	Laws 2007, Ch. 204
Taxes Applied Against	GRT (state portion)	CRS	PIT; CIT	PIT; CIT	PIT; CIT	PIT; CIT	GRT & Comp.
Credit rate	100% of assistance to small businesses up to per business limits and a total limit of $2.4 million per taxpayer	100% of GRT & Comp. Tax liability	50% of the value of land donated up to $100,000	Variable amount per kilowatt of renewable electricity generated	25% of expenditures on film production	Decreasing amount per gallon of biodiesel fuel blended	30% of costs up to $50,000
Eligibility		Less than 25 employees/$5 million of revenue; 20% of expenditures on research	Donations must be made to N.M., or to a 501(c)(3)	Ownership of electricity generating facility using renewable resources		Must be taxable gallons under the Special Fuels Tax	Certification by EMNRD required
PTE Allocation Rules	No	No	No	No	No	Yes	No
Carry Forward	No	No	20 Years	5 Years	No	5 Years	4 Years
Refund-able	No	No	No	Partial	Yes	No	No
Transfer-able	No	No	No	Yes	No	No	No
Recapture	No	No	No	No	No	No	Yes
Sunset	No	6/30/2009	No	31-Dec-17	No	31-Dec-12	No
Anti-Double Dip	No	Partial	No	Partial	No	Yes	No
Annual Cap	$4.8 million	No	No	$25 million	No	No	$1 million
Review Required	No	No	No	No	No	No	No

Business Tax Credits -- Continued

Alternatives Under Consideration

- **Require that all business tax credits apply only to investment in New Mexico, compensation of employees in New Mexico, or other qualifying activities or expenditures in New Mexico**

- **Carefully specify the qualifying periods, activities, etc. that entitles a taxpayer to a business tax credit**

  - **For example, the qualifying period for all investment-related credits might be based on the date property is placed in service**

- **Credits generally should be subject to recapture, in a specified manner, if the conditions of the credit are not met over a specified period of time following qualification for the credit**

  - **For example, investment-related credits should be recaptured if the property does not remain in service or is removed from New Mexico within a specified time following grant of the credit**

- **A department with expertise in the objectives of each business tax credit should be required to certify, monitor and evaluate the credit**

  - **Such requirements are not currently specified for all business credits, and fully specified for only a few credits**

  - **Ongoing monitoring and evaluation by the departments most knowledgeable about the credit is crucial to insure credits are cost-effective**

  - **Additional reporting requirements may be necessary for adequate monitoring and evaluation of business tax credits**

- **"Double dipping", the allowance of more than one credit or deduction for the same expenses, should be addressed explicitly in the statutory language for each credit**

- **Non-refundable and transferable credits provide less incentive than a refundable credit with the same rate**
  - **The present value of a credit to the entity performing the qualifying activity is reduced if the entity does not have sufficient liability to immediately absorb a non-refundable credit, or incurs transactions cost in transferring the credit**
  - **Transferred credits may reduce State revenues by the full amount of the credit, even though the qualifying entity receives only a fraction of that amount**
  - **Non-refundable and transferable credits also impose additional compliance costs on taxpayers, and additional administrative costs on TRD**
  - **A refundable credit could provide the same or even higher incentive to the qualifying entity at a lower cost to the State**
- **If a mix of non-refundable and refundable credits is retained, the stacking sequence of credits and their stacking order against taxes should be fully specified by statute**
  - **Carryforward periods likewise need to be fully specified for non-refundable credits, and perhaps made uniform**
- **The goals of simplifying and conforming the business credits might best be achieved by re-codifying the credits with general rules and definitions brought together in on section of the statues**